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Thank you, Mr. Chairman and members of the Subcommittee, for inviting me to speak today. My name is Arthur Middlemiss. I'm an assistant district attorney in Manhattan, and I work for Robert M. Morgenthau. Since late 2004, I have run a bureau at the Manhattan D.A.'s Office called Investigation Division Central, or IDC.

IDC, as does other office bureaus, prosecutes banking and securities frauds, many of them having international ramifications. Manhattan, a world center for banking and securities transactions, is home to many financial institutions, which sophisticated criminals use to defraud investors, companies, and even foreign governments of billions of dollars. Even in cases of domestic fraud, criminals often conduct some of their activities outside the United States, keeping funds and incriminating evidence overseas away from police and prosecutors. IDC works with foreign governments, victims, and multi-national corporations to conduct extensive international investigations so that it can uncover and prosecute large-scale frauds and thefts. Through IDC's efforts, more than one billion dollars has been returned to investors, and hundreds of defendants have been convicted and sentenced.

My comments today will focus in two areas: 1) the international money remittance business, and 2) the role offshore jurisdictions play in securities fraud cases here in the United States. I hope to explain some of the concerns that regulators and law enforcement have about some practices among banks and businesses in the money service industry, and to express Mr. Morgenthau's hope to encourage legitimate businesses, banks, and other financial institutions to take appropriate action when they see the red flags that should alert them to illegal activities.

Money Transmission and Money Laundering

The best way for me to give you some idea of the dimensions of the problems we are facing in regards to money laundering and the urgent need to do something about them, is to describe some of the cases involving money service businesses we have prosecuted at the Manhattan District Attorney's Office.

Over the past several years, the Manhattan District Attorney's Office has focused on underground remittance systems and the financial institutions that allow them to operate. To be sure, legitimate money service businesses play an important role in the lives of many New Yorkers, especially for recent immigrants, many of whom rely on check cashers to cash their checks, and on money remitters to send money home to their

families. However, unlicensed, and therefore unregulated, money service businesses pose to a threat to the integrity of the nation's financial system and to our safety and well-being.

As Mr. Morgenthau has said, "These underground remittance systems provide a window of opportunity for many types of criminals to move their ill-gotten gains: narcotics traffickers, gun smugglers, corrupt foreign politicians, and terrorists." To date, the Manhattan District Attorney's Office has prosecuted a number of these financial businesses, which together have wired more than $9.8 billion worldwide.

The businesses prosecuted by the Manhattan District Attorney were – like all money service businesses – obligated under both federal and state law to develop and implement effective anti-money laundering programs, to file suspicious activity reports ("SARs") with law enforcement if suspicious activity was identified, to follow currency transaction reporting ("CTR") requirements for transactions over $10,000, and to screen customers' identification against lists of known terrorists and narcotics traffickers ("OFAC"). In the face of those regulations, the subjects of the Manhattan District Attorney's investigation enabled their customers to avoid all regulatory scrutiny and to move massive amounts of money worldwide anonymously.

For example, in February 2004, with the assistance of the New York State Banking Department, Beacon Hill Services Corporation ("Beacon Hill") was convicted, after a jury trial, for operating as an unlicensed money transmitter; in its last six years of operation, Beacon Hill had moved more than $6.5 billion through accounts it maintained at a major New York bank.

Beacon Hill was operating as a money transmitter without a license, a felony under New York State law. Beacon Hill ran its money transmitting business out of offices on the seventh floor of a midtown Manhattan office building. It had about a dozen employees. It was open for business from 1994 to February 2003, when we executed a search warrant on the premises.

It is doubtful that very much of this money was moved through Beacon Hill for legitimate purposes. Legitimate clients would have dealt directly with a bank rather than pay the extra fees required to do business through Beacon Hill. What the clients got for their extra money was secrecy and protection from the scrutiny of government authorities. Beacon Hill did not keep proper records and much of its business was transacted with offshore shell corporations and "casas de cambio," or exchange houses, in Brazil and Uruguay. Accordingly, it was nearly impossible to identify the real parties in interest behind Beacon Hill's transactions, or to trace the money through the company's accounts. Nonetheless, it is reasonable to believe that a great portion of the money that passed through Beacon Hill's accounts was linked to unlawful capital flight, narcotics trafficking or other criminal activities. We do not know the extent to which the facilities of Beacon Hill may have been used to fund terrorist activities. Records do show, however, that Beacon Hill transmitted $31.5 million to accounts in Pakistan, Lebanon, Jordan, Dubai, Saudi Arabia, and elsewhere in the Middle East.

After the Manhattan District Attorney indicted Beacon Hill, we met with Brazilian police officials and prosecutors and representatives of a special commission investigating the movement of some $30 billion out of Brazil. Much of this was thought to be the proceeds of official corruption, government fraud, organized crime activities, and weapons and narcotics trafficking. More than $200 million of this money had moved through Beacon Hill and accounts at other New York banks; these funds were alleged to have belonged to Paulo Maluf, the former mayor and governor of the city and state of San Paolo, Brazil. Maluf now faces charges in Brazil that he stole hundreds of million of dollars as part of a construction kickback scheme.

The above-described meeting was not the only example of cooperation between Brazilian and New York authorities. In August 2004, Brazilian law enforcement authorities, in the largest operation of its kind, executed over 120 search warrants and over sixty arrest warrants, and charged over 100 individuals with money laundering and related financial crimes throughout Brazil as part of Operation "Farol da Colina" - Portuguese for "Beacon Hill." This operation was based in part on information gathered from the Manhattan District Attorney's investigation and prosecution of Beacon Hill. Close cooperation between the Manhattan District Attorney's Office and Brazilian federal police and prosecutors continues.

The Manhattan District Attorney has also focused on the role played by the United States banks and financial institutions that allow these illegal activities to go on. As the District Attorney has said, he will not "tolerate violations of the requirements that [U.S. financial institutions] know their customers and adhere to all anti-money laundering standards. Financial institutions that harbor illegal operations will be investigated and appropriate steps will be taken to ensure their compliance with the law."

For example, Beacon Hill itself conducted its business through accounts maintained, for nine years, at a major New York bank. This illegal business was able to flourish for as long as it did only because the bank closed its eyes to numerous warning signs that the accounts posed a high risk for money laundering.

There were several red flags raised by Beacon Hill's business that the bank involved should have recognized. First, many of Beacon Hill's clients were themselves in the business of moving money to South America, and the identities of their customers were unknown and unknowable by the bank. Wire transfer documents often identified the beneficiaries of transfers only as a "customer" or "valued customer." Other Beacon Hill clients were offshore shell corporations. A large portion of Beacon Hill's business was run out of a pooled account which served many customers, making it impossible to link deposits with transfers out of the account. Finally, the London office of the bank had shut down Beacon Hill's accounts in 1994 and, as the bank knew, Beacon Hill did not have a license to operate in the State of New York. As Mr. Morgenthau has stated, "It is fair to say that, in this case, the bank's compliance department completely fell down on the job."

As a result of leads developed during the Beacon Hill investigation, the District Attorney's Office launched an investigation into Hudson United Bank ("HUB"). On March 2, 2004, the District Attorney's Office reached a settlement with HUB relating to the failure of the HUB branch located at 90 Broad Street in Manhattan to monitor and assess accurately the money-laundering risks posed by its international wire transfer business. Specifically, the HUB accounts engaged in more than $65 million of transactions originating or terminating with individuals and companies doing business in the tri-border region of South America (formed by the borders of Paraguay, Argentina and Brazil), as well as with other bogus South American money transmitters. As part of the settlement, HUB agreed to reform its anti-money laundering policies and procedures, and to pay a total of $5 million to the City of New York, which included costs of the investigation.

During the course of both the Beacon Hill and HUB investigations, the District Attorney's Office developed leads indicating that Israel Discount Bank of New York ("IDBNY") accounts were also being used to facilitate and conduct illegal money transfers from Brazil. The investigation into those leads disclosed that IDBNY's private banking customers, both individuals and companies, would bring Brazilian currency to "doleiros" (foreign exchange houses) in Brazil. These doleiros are authorized to conduct currency exchanges in Brazil, but are not authorized to engage in foreign money transfers. The doleiros would then transfer money from the doleiro accounts at IDBNY to the private banking client's account at IDBNY. The funds would then go wherever IDBNY was instructed to send them. This process evaded Brazil's strict controls over foreign money transfers and was illegal in Brazil. Thus, in reality, the doleiros were conducting money transfer businesses in New York, through their operations in their IDBNY account.

In addition to breaking Brazilian law, this particular "nesting" violated United States and New York banking regulations and money laundering laws. IDBNY failed to maintain accurate and complete customer information in violation of state and federal rules. IDBNY's money-laundering policies, systems and controls failed to prevent illegal transfers from passing through accounts at IDBNY. IDBNY also violated regulations governing the filing of SARs by failing to report suspicious transactions in a timely manner and in an accurate and complete manner.

In a related operation, authorities in New York and Brazil took action against Transmar Turismo ("Transmar"), an illegal money transmitter with offices in Brazil, who had used its account at IDBNY to make illegal money transfers. While Manhattan prosecutors froze Transmar's account at IDBNY in Manhattan, the Brazilian federal police executed seven search warrants on the offices of Transmar, as well as at the offices and homes of its principal owners and officers. The president of the company, Algemiro Moutinho, was taken into custody pursuant to an arrest warrant issued by a Brazilian federal judge. Moutinho and two other officers of Transmar were charged with Money Laundering, Crimes Against the National Financial System (operating an illegal money remittance business), Managing a Financial Institution with Fraud, and Racketeering. Meanwhile,

prosecutors in Manhattan will seek to forfeit the assets in Transmar's New York accounts.

In short, the District Attorney's investigation revealed that IDBNY had deficiencies in its anti-money laundering policies and controls. As a result of those deficiencies, IDBNY failed to monitor the risks that its customers were engaged in illegal activity, and enabled certain bank customers to move over $2.2 billion illegally from Brazil into IDBNY.

Along with the New York State Banking Department and the Federal Deposit Insurance Corporation ("FDIC"), the District Attorney's Office entered a settlement with IDBNY that required IDBNY to install a regimen of compliance and controls to insure that the bank complies with all anti-money laundering requirements. In addition, IDBNY was required to pay $8.5 million to the City and State of New York, and to cover the costs of the investigation. IDBNY may face additional Civil Money Penalties not to exceed $16.5 million in the aggregate to NYSBD, the FDIC, and the United States Department of the Treasury's Financial Crimes Enforcement Network ("FinCen").

With the participation of the New York State Banking Department, the Manhattan District Attorney's Office has also prosecuted other illegal, unlicensed money service businesses operating out of Manhattan, some literally within a stone's throw of our Office. Three of these businesses successfully enabled their customers to move more than $132 million anonymously over the last five years to Vietnam. For the most part, the operators of these businesses simply used their bank accounts to conduct their transactions. They would take their customers' money, bundle it together, deposit it into bank accounts, and send it abroad, where it was separated and distributed according to the customers' instructions.

To their credit, some banks recognized that these businesses were unlicensed, and therefore illegal, and refused to do business with them. However, at least three New York banks allowed these illegal businesses to operate using bank facilities, even though the highly questionable nature of their activities should have been obvious to the banks. Of course, had the banks truly known their customer, and thus been positioned to assess whether their customer's activity was suspicious or not, they would have known that these businesses did not have licenses to transmit money, and thus were operating illegally.

In the case of these three businesses, some of the money involved was likely sent home by immigrants to support their families. We know that because some of the amounts were small, a couple of hundred of dollars. Other transactions, however, involved large sums of cash. Because these businesses were unlicensed, they did not file CTRs or SARs, and did not make and keep the records they were obligated to about their customers' activities; for that reason it is nearly impossible to sort out the legitimate transfers from the illegitimate. What we do know, however, is that if someone wanted to move a lot of money out of New York without garnering regulatory or law enforcement scrutiny -- and plenty of criminals want to do just that -- these illegal businesses provided an open window through which to do it.

Money laundering poses a real threat to our collective well-being because it facilitates a wide range of criminal activities, from tax evasion to international terrorism. Like other criminal organizations, international terrorist networks need money to function. Terrorist networks need funds for training and supplies and to support their operatives around the world; they also need to able to receive and transmit funds across national borders, including our own. In investigations at the Manhattan District Attorney's Office, we have seen tens of millions of dollars transmitted to and from parties in the tri-border region of Brazil, Argentina and Paraguay, which is notorious for supplying funds to terrorist groups in the Middle East.

Offshore Jurisdictions and Securities Fraud

I also want to comment on the role that offshore jurisdictions play in securities fraud cases here in the Untied States. Many of the New York-crimes investigated by IDC involve "offshore jurisdictions," tax havens such as the Cayman Islands, the Bahamas, and the British Virgin Islands, which have no significant economies of their own, but use their strict bank and corporate secrecy laws to attract money from more developed countries. Because of their unwillingness to share information with lawful authorities from other countries, these jurisdictions present extraordinary difficulties for regulators and law enforcement authorities in the United States and other developed countries. For the same reason, they present opportunities to criminals.

Companies and accounts in the tax haven countries often play an integral role in a securities fraud scheme. For example, the Manhattan District Attorney's Office has convicted four New York stockbrokers of using MasterCards issued on offshore bank accounts to launder more than $750,000 realized from fraudulent stock deals. The proceeds from the stock fraud were paid to the brokers into accounts at the Leadenhall Bank & Trust in Nassau, the Bahamas. The brokers, who have since been convicted of felonies and barred from the securities industry, withdrew more than $750,000, using MasterCards at ATM machines in New York City and Atlantic City, New Jersey, among other places.

Notably, it is not only stock fraudsters that use offshore debit cards for illegal ends. In July 2004, we convicted a doctor for evading taxes on $300,000 of income, $126,000 of which he put into an account at Leadenhall in the form of checks, ostensibly in payment of rent for his office. In fact, he owned the building in which he had the office. Like the crooked brokers, the doctor used a MasterCard to withdraw money at ATMs and to make purchases with the offshore funds. The doctor also used offshore accounts and a shell company to shelter another $76,000 of income that he failed to report.

In another case, a real estate agent used an account at Leadenhall to hide income of approximately $75,000 from her real estate business that was earned in New York. The real estate agent sent the money to the Bahamas by use of Fed Ex packages, the charges for which appeared on her American Express card. The defendant accessed the offshore

account from the United States by use of a debit card that she used to make purchases in Manhattan and elsewhere.

As part of the offshore credit card investigation, which was conducted with the assistance of the New York State Department of Taxation and Finance, we learned that, in 2001, 115,000 separate offshore MasterCard accounts were used in the New York, New Jersey, and Connecticut area. The MasterCards were used in 2001 to access over $100 million that had been deposited in banks located in at least seventeen secrecy jurisdictions, including the Bahamas, Barbados, Belize, and the Cayman Islands.

The same offshore tools available to the above-referenced stockbrokers, doctor and real estate agent to commit relatively simple securities crimes and to evade taxes are also used to conduct more sophisticated schemes. For example, in a 2003 case, a solicitor from London, England, Andrew Warren, pled guilty to Attempted Enterprise Corruption, a class "C" New York felony, in connection with a stock fraud conspiracy operating in Great Britain and New York.

The criminal enterprise was run by principals of Westfield Financial Corporation, a broker-dealer on Park Avenue, in Manhattan. In the scheme, securities were sold pursuant to SEC Regulation S - which permits the sale of unregistered securities to foreign investors -- to some twenty companies chartered in Liberia and the British Virgin Islands, and ostensibly managed from the Isle of Jersey, one of the Channel Islands. In fact, the offshore companies were merely nominees for insiders from the New York metropolitan area, who bought the Reg S stock on margin, ran up the price in trading between the Jersey companies, and used the stock they bought on the cheap to cover their own short sales, cashing in for millions at the expense of innocent investors and the companies that issued the stock.

In November 2002, two other lawyers were convicted on charges of participating in a related scheme. The defendants in that case, Stuart Creggy and Harry J.F. Bloomfield, were convicted of conspiracy and falsifying business records after a six-week trial.

Creggy was a senior partner at the law firm of Talbot Creggy in London. He was also a part-time Magistrate Judge for Westminster and Kensington, in London. Bloomfield had been a lawyer in Montreal, Canada, a senior partner in the Bloomfield, Bellemare law firm, a Queen's Counsel, and an honorary counsel for the country of Liberia. Creggy and Bloomfield recruited others, including Liberian diplomats, to pretend to be the owners of the off-shore companies. The off-shore companies, established in Liberia and the British Virgin Islands, among other places, were used by the defendants' clients for various purposes, including the Regulation S scheme that was the subject of Warren's guilty plea.

Another securities-related matter involved an offshore investment fund known as Evergreen Security, Ltd., which was chartered in the British Virgin Islands and had offices in the Bahamas. Investors in Evergreen, which was actually managed from offices in Orlando, Florida, were promised an annual return of 9% to 10% on funds nominally held in offshore trusts organized in the Bahamas and Costa Rica. In fact,

Evergreen was run as a Ponzi scheme, with the money from later investors being used to pay earlier investors. Thousands of Evergreen investors were defrauded. No doubt, it was the allure of investments in lucrative offshore trusts, marketed to the public as "asset protection trusts," that attracted so much money to Evergreen in the first place. Investors lost $330 million in fraud; Evergreen filed for bankruptcy in January 2001.

Five defendants were convicted in New York in connection with the thefts from the Evergreen fund totaling over $34.2 million. In each of the thefts, money was transferred from Evergreen to offshore shell companies controlled by one or more of the defendants. Other defendants, including one of those convicted in New York, were convicted in federal court in Tampa, Florida.

Offshore entities also played a central role in facilitating the notorious accounting fraud at Enron Corporation. In July 2003, the Manhattan District Attorney's Office, along with the SEC, announced a settlement with J.P. Morgan Chase and Citigroup, concluding an eighteen-month investigation into $8.3 billion in loans that had been structured by the banks in such as way that permitted Enron to account falsely for the transactions in its financial statements.

Our investigation showed that the loans to Enron were structured as prepaid forward commodities transactions between the banks, Enron, and ostensibly independent counterparties offshore. In fact, the offshore parties were so-called "Special Purpose Entities" located in the Isle of Jersey and the Caymans which the banks controlled and which were involved in the deals only to make them look like commodities trades; this was done to accommodate Enron's desire to be able to account for the revenue as cash flows from operations rather than cash from bank financings. These sham transactions contributed to Enron's collapse, which had disastrous effects for thousands of Enron's employees and shareholders.

As Mr. Morgenthau points out in his public remarks, which themselves are the source of the vast majority of information provided herein, there are international aspects to many, if not most, sophisticated frauds. In today's global economy, it is increasingly rare to encounter a significant financial crime that is strictly a local matter. Prosecutors pursue these cases to extent we can, but criminal investigations and prosecutions are far from a complete answer to the problem.

Law enforcement cannot do the job of policing illegal money flows alone. We need the cooperation of the money service and banking industries to know who they are dealing with and to help identify other businesses that may be operating illegally. And, we need the regulators to make certain that money transmitters and the banks are doing what the law requires. Finally, we need authorities here in the United States and abroad to make it more difficult for criminals and other lawbreakers to avoid proper scrutiny by conducting their financial affairs in offshore secrecy jurisdictions. These are difficult problems, and law enforcement needs all the help we can get.